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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

UNION PACIFIC RAILROAD COMPANY,
MISSOURI PACIFIC RAILROAD COMPANY,
THE WESTERN PACIFIC RAILROAD COMPANY, and
SPOKANE INTERNATIONAL RAILROAD COMPANY,
Petitioners,

v.

TERRY F. MORITZ, Trustee of
Iowa Railroad Company,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTION PRESENTED

Whether interline freight revenue, which is earned by one railroad but collected from the shipper by another railroad under industry practice and rules, is held in trust by the collecting railroad so that it cannot use such revenue as part of its general assets in a reorganization in bankruptcy.

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TERRY F. MORITZ, Trustee of
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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Union Pacific Railroad Company and three affiliates, Missouri Pacific Railroad Company, The Western Pacific Railroad Company and Spokane International Railroad Company ("Union Pacific"), hereby petition for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit (App., *infra*, 1a), is reported at 840 F.2d 535 (7th Cir. 1988). The Final Judgment Order of

the United States District Court for the Northern District of Illinois (December 31, 1985), granting petitioners' Motion for Summary Judgment (App., *infra*, 26a), is not reported. The revised Final Judgment Order of the United States District Court for the Northern District of Illinois (October 15, 1986), granting petitioners' Motion for Summary Judgment and holding that certain funds representing "interline balances" are held by respondent in trust for petitioners (App., *infra*, 38a), is not reported. The Final Judgment Order of the United States District Court for the Northern District of Illinois (December 16, 1986), imposing a trust on certain additional assets in the hands of respondent (App., *infra*, 47a), is not reported.

JURISDICTION

The opinion of the United States Court of Appeals for the Seventh Circuit was entered on February 23, 1988, and a petition for rehearing was denied on March 18, 1988. On June 3, 1988, Justice Stevens extended the time for filing a petition for certiorari to and including July 16, 1988. The jurisdiction of the Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT

Petitioners brought an action in the bankruptcy court seeking the payment of approximately $1.4 million of "interline freight balances," which were collected on their behalf by the Iowa Railroad Company (the "Iowa Railroad"), a railroad which had filed a voluntary petition for reorganization under the Bankruptcy Code (11 U.S.C. §§ 101, *et seq.*).[1] The funds in question represented interline freight revenue, *viz.*, payments collected by the Iowa Railroad from shippers for transportation provided

[1] Petitioners will refer interchangeably to the railroad in question, the Iowa Railroad Company, and Terry F. Moritz, the trustee in bankruptcy of the Iowa Railroad Company, as either the "Iowa Railroad" or "respondent."

by Union Pacific or its affiliates as participants in interline movements of freight with the Iowa Railroad. The district court in this case concluded that the portion of the funds collected by the Iowa Railroad, but earned by petitioners, was held in trust for the benefit of petitioners.

The court of appeals reversed, holding that the funds in question represented merely a debt owed by the Iowa Railroad to petitioners. App., *infra*, 23a. The decision of the court of appeals conflicts squarely with the decisions of other circuits on this important and recurring question of federal law that significantly affects the financial relationships between carriers in the railroad industry.

A. The Role of Interline Carriers in the Unitary National Rail System

Although some freight movements begin and end on the same railroad, many railway freight shipments in the United States are "interline" movements—interchanged over the lines of two or more railroads between origin and destination. Thousands of such interchanges occur daily among interline freight carriers across the nation, involving thousands of shippers and railroad cars and hundreds of interline carriers. The availability of interline rail transportation avoids unnecessary construction of parallel rail lines, advances the efficient operation of the interstate rail system and permits the nation's railroads to function as an integrated system. Interline rail transportation of freight is, in short, a constant and indispensable feature of this nation's interstate railway transportation system.

Rather than paying each participating railroad separately for its services in an interline movement, the shipper or receiver of freight makes a single payment to *one* railroad—either the origin or destination carrier—and that railroad collects and receives the portion of the

payment that belongs to the other carriers.[2] The interline railroads account to one another for such interline freight revenue on a monthly basis. The destination carrier uses the final "waybill" (which shows the complete movement of the freight) to compute the portion of the total revenue each railroad involved in each freight movement is entitled to receive. The destination carrier sends statements of these entitlements, called "abstracts," to all other railroads involved in the freight movement by the 14th working day of the month after the freight movement is completed and all waybill information is available.[3] These statements show the sums actually received from shippers for freight movements by other railroads. Using these statements, railroads then offset the amounts owed to each other for interline shipments, producing a net monthly "interline freight balance" between two railroads. See Union Pacific Exhibits A, B & F.[4]

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[2] The origin carrier collects shipping charges from the shipper if the shipment is sent prepaid; the destination carrier collects from the consignee if it is not prepaid. App., *infra*, 2a.

In addition to interline accounts for the movement of freight, there are at least five other categories of interline accounts for freight railroads: (1) per diem charges (*i.e.*, a charge for the use of another railroad's cars); (2) switching charges; (3) overcharges and car repairs; (4) loss and damage charges; and (5) miscellaneous bills.

[3] The destination carrier generally must undertake the responsibility of computing the division of revenue for an interline shipment because only the final waybill shows the complete movement of the freight which could change en route. App., *infra*, 17a-18a. Thus, it would be extremely difficult, if not impossible, for any party other than the destination carrier to determine the appropriate allocation of revenues.

[4] All citations to Union Pacific Exhibits in this petition refer to the Exhibits to Union Pacific's Memorandum in Support of Motion for Summary Judgment (August 15, 1985). The railroad for which the interline balance is being held can send a bill for the amount or, in some cases, prepare a sight draft against the bank account of the railroad that holds the balance. App., *infra*, 18a. The railroad which

The interline freight revenue collected by a small railroad like the Iowa Railroad[5] (a so-called "short line railroad"), can greatly exceed the net revenue actually earned by the railroad for its own services. For example, goods may be shipped from Iowa to Los Angeles, California—a distance of about 1500 miles. The shipment may travel over 100 miles of track operated by the Iowa Railroad, then interchange with the destination carrier, Union Pacific, and travel over 1400 miles of line operated by Union Pacific to its destination. When, as was often the case, the shipment is prepaid, the origin carrier, here, the Iowa Railroad, would collect the revenue for the entire 1500 mile shipment, even though it participated in only 100 miles of the haul. See Union Pacific Exhibit A. The amount collected by the Iowa Railroad on behalf of Union Pacific is Union Pacific's interline freight revenue. *Id.* When the Iowa Railroad filed its petition in bankruptcy, it had a net interline freight balance of approximately $4 million collected on behalf of other carriers, more than $1.4 million of which represented a net interline balance resulting from the Iowa Railroad's collection of revenues due to petitioners for their part of freight movements on interline shipments.

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is due the interline payment can then submit the sight draft, like a check, to the debtor's bank which will pay the draft in the ordinary course of business. *Id.* This eliminates the need to send a bill or invoice for the interline balance and generally allows for more prompt payment. This sight draft system, which has been prescribed by the Association of American Railroads, is used by all Class I railroads (*i.e.*, those with inflation-adjusted revenues in excess of $50 million per year) and about 250 smaller railroads that also voluntarily participate in the system. The Iowa Railroad was not participating in the sight draft system at the time of its bankruptcy.

[5] Respondent conducted operations, largely with rented equipment, over 511 miles of track, all of which was owned by other railroads. App., *infra*, 1a.

B. The Proceedings Below

1. On November 2, 1984, the Iowa Railroad filed a voluntary petition for reorganization under the Bankruptcy Code (11 U.S.C. §§ 101, *et seq.*).[6] On May 7, 1985, petitioners filed an adversary complaint against the Iowa Railroad and its trustee in bankruptcy seeking the turnover of over $1.4 million in interline freight charges which had been collected by the Iowa Railroad but not paid over to petitioners at the time of the bankruptcy. Petitioners argued that these prepetition interline freight charges were not property of the debtor's estate under 11 U.S.C. § 541, but were "held in trust by Debtor and the Trustee for [petitioners'] benefit . . . ." Complaint, ¶ 11.

On November 27, 1985, the district court delivered an oral opinion granting summary judgment in favor of Union Pacific. The court stated:

> It appears to me that Iowa Railroad simply has no claim to these interline receipts. Iowa Railroad did not earn these receipts, no services furnished by Iowa Railroad had anything whatsoever to do with the receipts that are claimed by Union Pacific and the other roads . . .
>
> Secondly, no creditor of the Iowa Railroad can possibly make any reasonable argument that it has a claim on these interline funds. No service rendered or effort expended or goods delivered by any creditor of Iowa Railroad had anything whatsoever to do with the generation of these interline funds.

November 27, 1985 Transcript at 7-12 (quoted in Brief of Plaintiffs-Appellees, Union Pacific Railroad Co., *et al.*, No. 86-2760 (7th Cir. March 25, 1987). Thus, the district court held that the interline funds were held in trust for petitioners. *Id.* The court found "no rational argument" to support the position of the trustee that the

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[6] On the same day, the United States District Court for the Northern District of Illinois withdrew the case from the bankruptcy court pursuant to 28 U.S.C. § 157(d).

relationship between petitioners and the Iowa Railroad was one of creditor and debtor. *Id.*[7]

On December 31, 1985, the district court entered a written "Final Judgment Order" reaffirming the holding set forth in its earlier oral decision.[8] In that order, the court made clear that, in its opinion, *In re Penn Central Transp. Co.*, 486 F.2d 519 (3rd Cir. 1973) (en banc), *cert. denied*, 415 U.S. 990 (1974) (*"Trust Fund Case"*) and its progeny "dictate that interline freight revenues collected by [the Iowa Railroad] and owed to Union Pacific are held in trust by [the Iowa Railroad] for the benefit of Union Pacific." App., *infra*, 29a.[9] Thus, the court ordered that "the Trustee shall pay said

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[7] In characterizing the equities of the situation, the court stated:

> What we have here is the anomalous situation of a small, unsuccessful, unprofitable, ma and pa railroad sitting on millions of dollars that it happens to have by virtue of having been basically the collection agent for the party which rendered the services generating those revenues and saying that it is entitled to use that money for the benefit of its managers, its attorneys, and its general creditors, and, indeed, for the purpose of reorganizing the railroad . . . .

Id.

[8] Although the order was signed on December 31, 1985, it was not entered on the docket until January 23, 1986.

[9] Iowa Railroad later moved for reconsideration of the December 31, 1985 Final Judgment Order on the basis of the Seventh Circuit's decision in *Boston and Maine Corp.* v. *Chicago Pacific Corp.*, 785 F.2d 562 (7th Cir. 1986), which held that pre-bankruptcy interline balances for per diem (*i.e.*, railroad car "rental") charges were general unsecured debt. The district court held, however, that the *Boston and Maine* case was distinguishable. The court reasoned that per diem charges—unlike interline freight revenues—represent a debt between railroads for "charges made between railroads for services rendered to each other." App., *infra*, 36a. Interline freight revenues, by contrast, are collected from third party shippers "by one railroad for services rendered [to the shipper] by another railroad." *Id.* Because there is no transaction between the railroads giving rise to a "debt," the court "adhere[d] to its view that the interline freight revenues are trust funds." *Id.*

trust funds pro rata to Union Pacific and other similarly situated interline railroads that hold duly proved and allowed claims for interline freight revenues." *Id.* at 33a.[10]

2. The Seventh Circuit reversed.[11] App., *infra*, 23a. According to the court, petitioners had "three possible

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[10] In determining which of respondent's assets were "trust funds," the court found that at the end of 1984, shortly after it had filed for bankruptcy, respondent had total assets of approximately $4.4 million, about $2.5 million of which were in cash or cash equivalents. Respondent had netted only about $112,000 in operations over the previous two years, and respondent was unable to suggest any source for these substantial assets other than the collected interline freight revenues held in trust for other railroads. The court thus concluded that "roughly $2.8 million in United States Treasury bills" held by the respondent "represents interline freight revenues earned by those railroads, but collected by [Iowa Railroad] or the Trustee." App., *infra*, 28a.

On February 20, 1986, the court *sua sponte* raised the question of whether "there was a sufficient factual basis" for finding that the fund in question "constitutes, in its entirety, interline freight revenues (and interest thereon)" or whether petitioners would have to trace the flow of the trust funds through respondent's accounts. App., *infra*, 34a-35a. After further briefing on this issue, the court issued an order more specifically identifying the assets of respondent to be impressed with the trust and holding that the interline claimants "have . . . sufficiently identified this money as interline trust funds." App., *infra*, 45a. In addition, the court, on December 16, 1986, entered a further order imposing a trust on certain additional assets of the respondent, including certain locomotives that were purchased by respondent with interline freight revenues. App., *infra*, 48a, 49a.

[11] At the outset, the court of appeals stated that the Bankruptcy Code did not resolve the status of the interline freight revenue. The court noted that during the consideration of the 1978 Bankruptcy Act, the Senate bill at one time contained a provision that would have required immediate payment in cash of "current net balances owed by the debtor [railroad] to other carriers on its interline freight, passenger and per diem . . . accounts . . . ." App., *infra*, 7a. Because the bill, as finally enacted, was based on the

sources of property rights: federal statutory law, federal . . . common law, and state law." *Id.* at 9a. With respect to federal statutory law, the court found nothing in the Interstate Commerce Act, nor the regulations promulgated thereunder, which expressly created property rights in interline freight revenue. Failing to find any express statutory support for the argument that interline freight balances are held in trust, the court concluded "that federal statutes and regulations do not support the interline creditors." *Id.* at 11a.

Turning to federal common law, the court noted that "shippers' ability conveniently to send freight over a network of connected railroads is an important federal objective, making some co-operation among railroads essential." *Id.* However, the court asserted that treating interline freight revenue as unsecured debt would not unduly interfere with that federal objective because the risk to the "creditor" railroads was not likely to cause them to discontinue the practice of providing shippers the "convenience" of the current single billing system.[12] The court reasoned that there were "ways to deal

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House version, which did not contain the provision in the Senate bill, the court stated "[w]e cannot give the bill, as enacted, a meaning that was confronted and deleted." *Id.* at 8a. Thus, the court concluded that the 1978 Act left the state of the law unchanged and that the question presented turned on the "type of property interest" held by petitioners in the interline freight revenue.

[12] Even if the railroads discontinued the practice of single billing due to the risk of loss involved if interline revenue is treated as unsecured debt, the court stated that "[t]his is at most a question of convenience." App., *infra*, 12a. Because "the inconvenience of separate invoicing would not strike at the life blood of interstate commerce," the court did not find any "substantial conflict between state law and the achievement of an objective defined by federal law" sufficient to support the conclusion that federal law must control. *Id.* The court performed no analysis of the effect of separate invoicing on the railroads' costs or whether discontinuing single billing would cause any shippers to choose other modes of transportation, to the detriment of the railroad industry.

with the risk of default by collecting carriers on the balances remaining after the automatic setoffs." *Id.* at 13a. For example, the court suggested that railroads "scrutinize the creditworthiness of their trading partners" or require "[c]ollecting carriers with shaky finances" to "post bonds [or] secure letters of credit." *Id.*[13]

Based on its view of the economics of the railroad industry and the treatment of interline balances in other industries, the court of appeals stated that it simply "d[id] not agree" with Judge Adams' concurring opinion in the *Trust Fund Case*, 486 F.2d at 527, which held, as a matter of federal common law, that interline freight balances should be treated as trust funds in the hands of the collecting railroad. App., *infra*, 16a.[14]

Finally, with respect to the status of the interline freight collections under state law, the court of appeals began its analysis by stating that the majority opinion in the *Trust Fund Case* had concluded—as a matter of "state law"—that such balances are held in trust. App., *infra*, 16a.[15] The court then set forth the basis of its dis-

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[13] With respect to the costs of such financial arrangements—and the resulting impact on the interstate movement of freight—the court observed that "[t]he economy teems with such devices. Standby letters of credit assure payment for billions of dollars of transactions daily." *Id.* at 13a.

[14] The court of appeals emphasized its disagreement with Judge Adams who argued for a broader holding, based on the impact of the interline balance issue on national railroad policy. This emphasis by the court below on Judge Adams' opinion should not obscure the fact that the Seventh Circuit's decision in this case is in square conflict with the Third Circuit's *holding* in the *Trust Fund Case* and with the majority's rationale for holding that interline freight balances are trust funds. See *infra*, pp. 13-14, 16-17.

[15] The court chided the parties for failing to undertake an analysis of which state's substantive law should be applied by the federal court in Illinois (*id.* at 17a) and stated that, in the absence of any indication to the contrary, Illinois law should apply. In fact, there has never been any suggestion by any party that the choice of

agreement with the Third Circuit's analysis of the common law issues.

With respect to the creation of a common law implied trust, the court noted that in the *Trust Fund Case*, the debtor (Penn Central) was a Class I railroad that was using the sight draft system which allowed turnover of interline balances almost immediately after computation of the amount due. See, *supra* p. 4, n.5. Here, the court held that because respondent did not turn over interline freight revenue immediately and petitioners did not "protest the slow payment" or require the segregation of accounts, App., *infra*, 20a, it was apparent that respondent "treated other railroads as trade creditors, and . . . they acquiesced in this treatment." *Id.* The court held that this "evidence" of a debtor/creditor relationship, and the lack of any "external expression" of a trust relationship, precluded a finding of an implied trust.

With respect to a resulting trust, the court stated that the facts of this case did not fit the "paradigm . . . [where] A sells stock to B, which places the certificates with C to be held in street name[] [and] C [therefore] is trustee for B." App., *infra*, 21a. The court held that because petitioners did not show that shippers intended the Iowa Railroad to hold Union Pacific's portion of the charges in trust for Union Pacific, no resulting trust could arise in petitioners' favor. *Id.*

Finally, the court held that a "constructive trust" may be established where a person holding title to property may be "unjustly enriched" if he is allowed to keep it. The court stated that:

> [t]here could be a decent claim of unjust enrichment if we had to decide whether the Iowa's stockholders

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law issue would affect the outcome of this case, and the court of appeals (like the parties) relied primarily on the statement of general common law contained in the Restatement (Second) of Trusts (1957).

> or the interline railroads should get the money remaining in the Iowa's coffers; it would unjustly enrich the stockholders to receive this money. But that is not the problem. The question is whether the interline railroads get all of the money and the suppliers of diesel fuel (and tort creditors) none . . . . All of the Iowa's creditors have supplied valuable goods and services; all have been stiffed.

Id. at 22a. Thus, the court held that it would be inappropriate to apply the constructive trust doctrine "to settle priorities among bona fide business suppliers." Because it could find no basis for imposing a common law trust, the court concluded "that the interline balances are general, unsecured debts of the [respondent]." *Id.* at 23a.

REASONS FOR GRANTING THE PETITION

The decision below directly conflicts with the holdings of four other courts of appeals that interline freight revenues are held in trust by the collecting railroad. See *Trust Fund Case*, 486 F.2d 519; *Chase* v. *Committee of Interline R.Rs.* (*In re Ann Arbor R.R. Co.*), 623 F.2d 480 (6th Cir. 1980); *Southern Ry. Co.* v. *Flournoy*, 301 F.2d 847 (4th Cir. 1962); *Southern Ry. Co.* v. *United States*, 306 F.2d 119 (5th Cir. 1962). Moreover, the question presented raises an important and recurring issue of federal law that will have a substantial effect on the operation of the unitary national rail system and on every railroad engaged in interstate commerce.

1. The decision below flatly conflicts with the leading opinion of the Third Circuit (en banc) in the *Trust Fund Case*. In that case, the Third Circuit "accommodat[ed] and appl[ied] traditional common law trust principles to the unique regulatory scheme and accounting policies used by the nation's railroads [to] conclude[] that transportation and freight charges, *when collected*, are held in trust for the [interline railroads]." 486 F.2d at 524 (emphasis in original).

In the *Trust Fund Case*, as in the present matter, the collecting railroad, the Penn Central, had filed for reorganization in bankruptcy at a time when it had collected but not paid out a substantial interline freight balance. After reviewing the system for collecting and accounting for interline balances, the majority of the Third Circuit, sitting en banc, noted first that "the collection by Penn Central as an agent of money due and owing the other railroads suggests a trust." *Id.* The court also found it suggestive of a trust relationship that there were no provisions for the payment of interest by the collecting carrier.[16]

However, the Third Circuit also recognized that the interline "creditor" railroads had permitted the Penn Central to "commingle monies due them with Penn Central's general revenues." *Id.* Such commingling "generally" suggests the absence of a trust, but the court concluded that it was "only one indicium" of the relationship and that it "ha[d] minimal significance" in this context. *Id.* at 524-25. Contrary to the Seventh Circuit, which relied in large part on the commingling of funds to reject the notion of an implied trust, App., *infra*, 19a-20a, the Third Circuit found that the "unique and complex" system of accounting for interline freight shipments rendered the segregation of funds deriving from those shipments "practically and economically" unfeasible. 486 F.2d at 525. Rather, the majority held that enough "traditional indicators of a trust relationship" were present to conclude that the interline freight revenues were held in trust by the Penn Central for the benefit of the interline railroads. *Id.* at 527. Finally, the court noted that its decision—based on "recognized trust and pragmatic considerations"—"supports the congressional policy encouraging interline rail transportation of freight and passengers nationwide." *Id.* at 527.

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[16] Generally, in a debtor-creditor relationship, the "right to use another's money" gives rise to "the obligation to pay interest." *Id.*

Judge Adams concurred in the decision, arguing that the majority should have held that "even in the *absence* of anything formally resembling a 'trust,' the interlines are entitled to a preferred position with respect to freight and passenger revenues owed them by a railroad in reorganization." *Id.* at 533 (emphasis in original). Judge Adams was concerned that "exclusive reliance upon the narrow principles" of the common law to establish the federal rule might, in some other case, "seriously thwart the policy expressed in the Interstate Commerce Act" of encouraging interline rail transportation of freight nationwide. Thus, he argued for a broader rule based less on traditional trust principles and more on the significant federal interests at stake. *Id.* at 533.

The *Trust Fund Case* decision was followed by the Sixth Circuit in *In re Ann Arbor R.R. Co.*, 623 F.2d 480. In that case, the interline railroads sought, *inter alia*, payment for interline freight revenues collected by the Ann Arbor Railroad prior to its bankruptcy. The district court granted the petition of the interline railroads "holding that the freight charges must be treated as trust funds," and the trustee appealed. *Id.* at 482. The court of appeals rejected the trustee's arguments that the commingling of funds precluded the establishment of a trust, stating that it was "persuaded by the reasoning of the court in the *Trust Fund Case* and the concurring opinion of Judge Adams . . . ." The court also stated that it found:

> no logic in the contention that one bankrupt railroad may retain funds belonging to another interline railroad . . . which the collecting carrier was required to pay under the established practice and procedure required by the Interstate Commerce Commission, the Regional Rail Reorganization Act and the rules of the Association of American Railroads.

Id. at 482. Accordingly, the court affirmed the finding that the interline freight charges must be treated as

trust funds and given the requisite priority in the bankruptcy. *Id.*

Finally, the Fourth and Fifth Circuits, in cases which preceeded the *Trust Fund Case*, also have reached results that conflict with the decision of the Seventh Circuit. Although these courts did not anticipate the reasoning of the Third Circuit in the *Trust Fund Case*, they did hold that interline freight balances should be treated as trust funds. In *Southern Ry. Co.* v. *Flournoy*, 301 F.2d 847 (4th Cir. 1962), the interline railroads argued that their claims for interline freight balances should take priority over certain mortgage liens. After noting that the interline railroads were required to accept interline transfers and that interline balances were "contained in current revenues," the Fourth Circuit agreed that "interline accounts are an equitable lien on the railroad properties and outrank the mortgages." 301 F.2d at 854. The same governing principle regarding the status of interline balances was articulated in *Southern Ry. Co.* v. *United States*, 306 F.2d 119 (5th Cir. 1962), in which the interline carrier argued that the interline balance should be treated as "trust funds" and given priority over certain tax claims. The court agreed with the contention of the interline railroad that at the time the interline balances were settled, the "funds, rightfully collected and mingled, acquire[d] a 'trust' character." *Id.* at 125. However, because the interline carrier knew that "the Receiver was using its money, its supplies, and its facilities on which to run the Railroad" but nevertheless waited for well over a year to demand payment, the court decided—apparently on a laches theory—that the interline balance claim was not "entitled to preference." *Id.* at 125.

The Seventh Circuit's holding that there is no basis, under either federal or state law, to treat interline balances as trust funds cannot be reconciled with the decisions of the Third, Fourth, Fifth or Sixth Circuits on this issue. Indeed, the Seventh Circuit expressly stated

that it disagreed with the premise of the Third Circuit's holding on the federal common law issue. According to the court below, a holding that interline freight balances are trust funds, as a matter of federal common law, turns on the "belief that treating interline railroads as unsecured creditors would compel them to deny to customers the convenience of unitary billing." App., *infra*, 12a-13a. Assuming that the Seventh Circuit's summary of the sole basis of the holding in the *Trust Fund Case* is correct—which it is not—the court could not be more candid in its conclusion that it simply "do[es] not agree" with that analysis. App., *infra*, 16a. Other than this recognized disagreement on the appropriate federal common law rule, the cases are indistinguishable.[17]

The Seventh Circuit asserts that the Third Circuit's majority opinion ultimately turned on state law, but that claim is without support. The court below pointed to no statement in the majority opinion in the *Trust Fund Case* indicating that the majority was applying state law on this issue. Nor is there any such statement in the majority opinion.

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[17] The court below suggests that the cases may be distinguishable because the Penn Central participated in the sight draft system for paying interline balances—which gave "creditor lines effective dominion over the funds"—while the respondent did not participate in that system. App., *infra*, 19a-20a. This distinction, however, mischaracterizes the effect of the sight draft system and is, in any case, irrelevant to the legal issue.

In the *Trust Fund Case*, the funds remained within the complete control of the Penn Central; in fact, the Penn Central *stopped payment* on the sight drafts. Thus, it is plain that the "creditors" in that case had no more ultimate "dominion" over the interline funds than did the petitioners. Indeed, "creditors" have no greater or lesser control over interline freight balances under the sight draft system; the only advantage to "creditors" under that system is that it generally allows for faster payment. In any case, the status of those funds is a substantial question of federal law. See *supra*, pp. 13-14.

In any case, the Third Circuit itself has laid the dispute to rest. In its subsequent opinion in *In re Lehigh and New England Ry. Co. (Appeal of Central Jersey Indus., Inc.)*, 657 F.2d 570 (3rd Cir. 1981), the court identified federal common law as the basis of the holding in the *Trust Fund Case*. In *Appeal of Central Jersey Indus., Inc.* the court held that, where the trust funds have been dissipated, the claims of interline freight creditors do not take priority over the claims of a secured bondholder. In so holding, the court reaffirmed that "funds received from freight and passenger revenues by a collecting railroad were to be held in trust . . . ." *Id.* at 576. The court also stated that such questions involving the priority of competing claims to the assets of railroads in reorganization "implicate wholly national concerns and therefore should be governed by federal law." *Id.* Thus, the statement by the court below that the Third Circuit relies on "state law" for its rule of decision is flatly incorrect. App., *infra*, 3a. See *Trust Fund Case*, 486 F.2d at 527 (majority opinion) (decision based on "recognized trust and pragmatic considerations" which "support[] the congressional policy encouraging interline rail transportation"); see also 486 F.2d at 531 (concurring opinion).[18]

At bottom, both the Third and Seventh Circuits turned to the Restatement (Second) of Trusts for the governing rule of trust law. The difference in the opinions is not

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[18] Moreover, Judge Adams' concurring opinion offers no suggestion that its disagreement with the majority is based on the application of a different source of substantive law. Indeed, Judge Adams *agreed* with the majority's conclusion based on the application of traditional "time-worn tenets of trust law" to the situation at hand, but he argued for the establishment of a broader, more generalized federal rule based on "closer attention to pragmatic factors and to Congressional pronouncements . . . ." *Id.* at 531. Thus, both the majority and concurring opinions looked to federal common law as the source of the rule of decision and both reached a different conclusion than did the Seventh Circuit in the decision below.

based on any choice of law; instead, the difference in the opinions is their conclusions concerning the appropriate federal common law rule. The undeniable fact is that this case would have been decided differently if it had arisen in the Third (or Fourth, Fifth or Sixth) Circuit. All four of these courts have stated that unpaid interline freight balances should be treated as trust funds; only the Seventh Circuit treats them as debt. Given this clear conflict in the circuits, this petition presents an appropriate vehicle for this Court to resolve the issue of the status under federal law of interline freight revenues in the hands of the collecting railroad.[19] Accordingly, the Court should grant certiorari to resolve the issue.

2. The question presented in this case is particularly worthy of review because of the practical effect of the decision below on the railroad industry and on the "Congressional policy of 'encouraging interline rail transportation of freight and passengers nationwide." See *Appeal of Central Jersey Indus.*, 657 F.2d at 575 (quoting *Trust Fund Case*, 486 F.2d at 527); (reflecting Congressional policy to "ensure the development of a sound rail transportation system . . . to meet the needs of the public and the national defense." 49 U.S.C. § 10101a(4).

As the Seventh Circuit expressly recognized, the participation of railroads in the current system of interline

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[19] A decision by this Court on this issue also may resolve uncertainty regarding the status of interline balances for per diem charges. See *Gibbons* v. *Atchison, Topeka and Santa Fe Ry. Co. (In re Chicago, Rock Island and Pacific R.R. Co.)*, 537 F.2d 906 (7th Cir. 1976), *cert. denied*, 429 U.S. 1092 (1977) (ordering immediate payment of per diem interline balance in furtherance of ICC policy); *Trust Fund Case*, 486 F.2d at 528 (treating per diem interline balance as debt); *In re Boston and Maine Corp. (Appeal of Maine Central R.R. Co.)*, 600 F.2d 307 (1st Cir. 1979) (denying immediate payment of per diem interline balances); *Boston and Maine*, 785 F.2d 562 (refusing to overrule *Gibbons* and disallowing offset of prebankruptcy and postbankruptcy interline per diem balances); but see *Boston and Maine*, 785 F.2d at 567 (Coffey, J., concurring) (arguing that decision "effectively overrules" *Gibbons*).

transportation, which provides for monthly collection of interline balances, gives rise to a need for some "security" to "deal with the risk of default by collecting carriers on the balances remaining after the automatic setoffs." App., *infra*, 13a. Thus, regardless of whether petitioners or respondent are correct on the merits, the operation of the nationwide unitary rail system is best served by certainty in the rule of law that controls this issue. If, as the court below held, interline balances are merely unsecured debt, and thereby subject to loss in bankruptcy, then all interline carriers must review their current practices to determine whether and how the present accounting and collection methods can be modified to protect their interests. However, the industry cannot continue to operate effectively under a system where the security of millions of dollars in operating revenue depends on the federal circuit in which the bankruptcy occurs. Review of the decision below by this Court therefore is critical if there is to be a uniform federal rule which can bring certainty to an area of fundamental importance to the nation's railroads.

Even assuming that the current system, which provides shippers with the ability to pay a single carrier for an entire movement of freight, were simply a matter of "convenience," see App., *infra*, 13a, modification of that system would be a substantial undertaking. The existing system of collecting and accounting for interline balances is carefully designed, based on decades of industry experience, to encourage and facilitate the Congressional policy of developing efficient interline transportation of freight. See Association of American Railroads, Railway Accounting Rules (1984) (Union Pacific Exhibit C); see *Trust Fund Case*, 486 F.2d at 531 (Adams, J., concurring).[20]

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[20] Even as early as 1935, it was recognized that this system presents a "convenience so great as to be imperative . . ." *Atlantic Coast Line R. Co.* v. *Pennsylvania R. Co.*, 12 F. Supp. 720 (E.D. Pa. 1935), quoted in *Trust Fund Case*, 486 F.2d at 532, n.7.

Moreover, as the Sixth Circuit noted in *In re Ann Arbor R.R. Co.*, the *Trust Fund Case* is a "landmark decision," 623 F.2d at 481, that has been relied upon both by the courts and by the industry. In light of the uncertainty created by the Seventh Circuit's departure from the previously uniform treatment of interline freight balances since the *Trust Fund Case*, some modification of the system of interline balances likely will have to occur if the Seventh Circuit's decision is not reversed. Modification of the system, and the resultant impact on the interline rail network, should be required only after full review by this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 86-2760 and 87-1082

IN THE MATTER OF: IOWA RAILROAD COMPANY,
Debtor.

UNION PACIFIC RAILROAD COMPANY, et al.,
Plaintiffs-Appellees,
v.

TERRY F. MORITZ, Trustee of Iowa Railroad Company,
Defendant-Appellant.

Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 85 C 4463—John F. Grady, *Chief Judge*

ARGUED JUNE 3, 1987—DECIDED FEBRUARY 23, 1988

Before EASTERBROOK and RIPPLE, *Circuit Judges,* and GRANT, *Senior District Judge.**

EASTERBROOK, *Circuit Judge.* The Iowa Railroad endured from October 1981 to November 1984. During these years it conducted operations, largely with rented equipment, over 511 miles of other lines' track. Much of

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* The Honorable Robert A. Grant, of the Northern District of Indiana, sitting by designation.

its business involved freight handled by two or more carriers. When the Iowa was the first carrier—for example, when picking up a shipment of grain that it would turn over to the Union Pacific for the haul to the west coast—it collected the charge for the entire movement. Other carriers would do the same for shipments they originated in which the Iowa was the terminating line. At the end of the month, the Iowa and its business partners sent each other vouchers showing the sums they had collected for transportation provided on other lines. Perhaps the Iowa would collect $50,000 on behalf of the Union Pacific, and the Union Pacific $10,000 on behalf of the Iowa. The carriers would set off these amounts, producing an "interline balance". If the difference ran in the Union Pacific's favor, that railroad sent the Iowa a bill. When the Iowa filed its petition in bankruptcy, it owed interline balances of about $4 million for shipments of freight, more than $1.4 million to the Union Pacific alone. We must decide whether the railroad creditors have first claim to the Iowa's assets on the ground that interline balances are held in trust for other railroads. If the interline balances are trust funds, then the railroads will be paid in full and the Iowa's other creditors get next to nothing; if they are general unsecured debts, all creditors will receive about 64% of their claims.*

The district court held that the interline freight balances are trust funds, with corresponding priority. The court did not rely on any provision of the Bankruptcy Act or state law. It relied, instead, on *In re Penn Central*

* The Iowa has assets of about $4.4 million in cash and receivables, plus some machinery. The interline creditors lay claim to $4.06 million; the Iowa's trustee concedes the validity of these claims but disputes their priority. Other creditors claim $1.9 million; these, too, are largely undisputed. A suit pending against the Iowa has an ad damnum of $7.2 million; and if these plaintiffs prevail in full, the railroad's debts would exceed $13 million, with correspondingly smaller payoffs for all creditors in the event the interline balances are general unsecured debt.

Transportation Co., 486 F.2d 519, 531-33 (3d Cir. 1973) (en banc) (Adams, J., concurring), in which Judge Adams—rejecting the majority's conclusion that interline balances are trust funds only to the extent state law so characterizes them—concluded that interline creditors are entitled to a preference because of "Congress' interest in creating and maintaining a viable interline rail system". *Id.* at 533. Judge Adams believed that a preference in bankruptcy is essential to ensure that railroads participate in a system in which carrier collects the entire cost of the movement; the abolition of this single-bill system, Judge Adams feared, "would greatly impede the smooth and efficient functioning of the through-route network." *Id.* at 532. The district court in this case added: "Principles of common sense and elemental justice require that the railroad which earned this money be declared to be its owner."

I

We may dispose summarily of the argument from "common sense and elemental justice". The railroads that moved the freight are entitled to be paid—but so are the people who supplied it with diesel fuel, and its other creditors. All of these persons contributed essential ingredients of the movement of the freight and earned their right to payment. That the interline creditors have been short changed by the Iowa does not imply that the other creditors should get nothing. Justice in a bankruptcy case is decision according to law. If the Iowa's general creditors have the same sort of property interest as the interline creditors, then justice requires courts to recognize both interests. As we said in *Boston & Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562, 566 (7th Cir. 1986), another case involving interline balances:

> [The district court thought] that considerations of equity overrode the law. But equity in law *is* the consistent application of legal rules. The definition of *in*equity is unequal application of norms. *Federated*

> *Department Stores v. Moitie*, 452 U.S. 394, 401 (1981). The bankruptcy law treats all pre-bankruptcy claims of the same class equally. When one claimant gets treatment that is denied to others, they have been treated inequitably.

See also, e.g., *Bonded Financial Services, Inc. v. European American Bank*, No. 87-1551 (7th Cir. Jan. 19, 1988), slip op. 9; *In re Chicago, Milwaukee, St. Paul & Pacific R.R.*, 791 F.2d 524, 528 (7th Cir. 1986); *Guerin v. Weil, Gotshal & Manges*, 205 F.2d 302, 304 (2d Cir. 1953) (A. Hand, J.). The decision in this case turns on property rights, not notions of equity.

II

Unless a specific provision of the Bankruptcy Code requires a different result, the function of bankruptcy law is to marshal the debtor's assets and distribute them according to the property rights of the creditors. (We put to one side managerial tasks such as maintaining the firm during a reorganization.) These property rights are defined in most cases by state law. When they are so defined, the bankruptcy court must implement rather than alter them. *Butner v. United States*, 440 U.S. 48, 54-57 (1979); *In re American Reserve Corp.*, No. 87-1768 (7th Cir. Feb. 18, 1988); *Boston & Maine*, 785 F.2d at 565-66. We said in *Boston & Maine* that interline creditors do not get special treatment. It remains to be seen, however, just what the ordinary treatment may be. State law is the principal but not the only source of property rights; federal law, too, may supply these rights, and the pervasive federal regulation of the rail business requires us to scrutinize federal law with some care. The survey is animated, however, by the principle that we are looking for legal entitlements rather than for the arrangements that seem to us best.

We start with the question whether the Bankruptcy Code settles the subject. The trustee says that it does, in

his favor. Since the trustee believes that the 1978 Code disposes of the subject by *not* discussing it, the appreciation of the argument requires a bit of background.

Railroads have been turning belly up with great frequency ever since Stephenson's "Rocket". Interline operations have been common since the founding of American roads, so the treatment of interline balances also is an old subject. See *Miltenberger v. Logansport Ry.*, 106 U.S. 286, 293 (1882). Until 1933, when Congress added § 77 to the old Code, 11 U.S.C. § 205 (1976), all railroad bankruptcies were handled as equity receiverships; under § 77 the ICC acquired a principal role in reorganizations but the principles of the common law continued to govern most relations among creditors. The rules for equity receiverships permitted courts to enhance the priority of debts incurred as operating expenses within the six months prior to insolvency or necessary to the continued operation of the debtor. *See Miltenberger*, 106 U.S. at 311. Courts applied these principles, without extended discussion, to interline balances. E.g., *Gregg v. Metropolitan Trust Co.*, 197 U.S. 183 (1905); *Southern Ry. v. Flournoy*, 301 F.2d 847, 850-53 (4th Cir. 1962); *Southern Ry. v. United States*, 306 F.2d 119 (5th Cir. 1962); *In re Tennessee Central Ry.*, 316 F. Supp. 1103, 1110-12 (M.D. Tenn. 1970), vacated on other grounds, 463 F.2d 73 (6th Cir. 1972). This approach assumed that interline balances are general, unsecured debts. Not until 1967 did any interline creditor argue that the balances are "trust funds" or otherwise entitled to priority exceeding that available to other operating expenses. *In re Central Railroad Co. of New Jersey*, 273 F. Supp. 282, 288 (D.N.J. 1967), affirmed by adoption, 392 F.2d 589 (3d Cir. 1968), brusquely replied: "That they are not trust funds is clear. The relationship among the several carriers engaged in an interline freight movement is that of debtor and creditor."

The Third Circuit took a different path in its en banc decision of 1972. It distinguished among kinds of interline balances. Those for freight and passenger transportation, it concluded, are collected by one carrier and held in trust for others. 486 F.2d at 523-27. (We discuss in Part V the court's grounds for this conclusion.) Other interline balances--per diem car charges (rental of one line's cars being used by another pending their return), switching charges, and several other categories—the court thought were general unsecured debts, largely because the debtor did not collect a specific charge from customers for these balances and so did not generate a fund. *Id.* at 527-29. The trust funds for pre-bankruptcy balances must be turned over immediately, the court held, regardless of the claims of competing creditors. The other balances, however, could be retained pending final reckoning. In 1976 we took still a different approach, holding that ICC rules required the immediate payment in full of pre-bankruptcy interline per diem balances, whether or not they were trust funds. *In re Chicago, Rock Island & Pacific R.R.*, 537 F.2d 906 (7th Cir. 1976). Interline freight and passenger balances were current operating expenditures to be paid as they arose. Other pre-bankruptcy balances would be treated as unsecured debt. The Third Circuit promptly rejected this holding, reiterating its position that per diem car charge balances are general, unsecured debts. *In re Penn Central Transportation Co.*, 553 F.2d 12 (3d Cir. 1977).

When Congress overhauled bankruptcy law in 1978, then, the Third Circuit treated passenger and freight balances (but not others) as trust funds; this court treated passenger and freight balances as current operating expenses and per diem accounts as trust funds; other courts had been silent since 1963. The rules in force in the Third and Seventh Circuits had two effects: priority for certain debts, and immediate payout (rather

than payment with other secured creditors at the end of the case).

Lobbyists for solvent (creditor) railroads tried to consolidate and extend these gains. The House passed a bankruptcy bill first, including nothing on the subject. The principal bill pending in the Senate, S. 2266, 95th Cong., 1st Sess. (1977), contained a provision (§ 1169) authorizing a railroad's trustee to pay in full all pre-bankruptcy interline balances without waiting for a court to approve the payment. Witnesses for creditor railroads objected to this on the ground that it did not *require* the trustee to pay these claims. *Hearings on S. 2266 and H.R. 8200 Before the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary*, 95th Cong., 1st Sess. 759-71 (1977) (testimony on behalf of the Association of American Railroads and the Union Pacific Railroad). The Committee then reported, and the Senate passed, a bill providing:

> [T]he debtors under this chapter *shall pay in cash* pursuant to statutory, [ICC], or recognized rail industry settlement procedures, or Commission orders of general applicability, the current net balances owed by the debtor to other carriers on its interline freight, passenger and per diem . . . accounts for the periods both prior and subsequent to the date of filing of the petition without the necessity of court approval.

Section 1168(1) of S. 2266, as passed (emphasis added).

The House did not accept this part of the Senate's bill, and the Senate capitulated. The Code as enacted does not so much as mention interline balances. See 11 U.S.C. § 1166, the provision into which § 1168 of the Senate bill envolved. The managers from each side remarked: "[T]he proposal contained in Section 1168(1) of the Senate bill is rejected as violative of the principle [of]

equal treatment of all creditors under title 11." 124 Cong. Rec. 34008 (Oct. 5, 1978) (Sen. DiConcini), 32409 (Sept. 28, 1978) (Rep. Edwards). (The bill lacks a conference report, but its managers in each chamber read identical explanatory statements into the Congressional Record.)

The failure of the industry's lobbyists was among the considerations that led the First Circuit in *In re Boston & Maine Corp.*, 600 F.2d 307, 313 (1st Cir. 1979), to reject *Chicago, Rock Island* and conclude that interline per diem car balances should be treated as general, unsecured debt. We then concluded in *Boston & Maine v. Chicago Pacific*, 785 F.2d at 567, that *Chicago, Rock Island* had been effectively overturned. Our *Boston & Maine* decision held that pre- and post-bankruptcy interline balances are not "mutual" debts and may not be offset. The Iowa's trustee argues that the events of 1978 also dispose of the Third Circuit's holding that interline freight and passenger balances are trust funds.

Doubtless the excision of language from a pending bill may be highly informative. E.g., *Carey v. Donahue*, 240 U.S. 430 (1916). We cannot give the bill, as enacted, a meaning that was confronted and deleted. So if the interline creditors try to rely on the 1978 Code they must lose. But they do not rely on the Code; they rely on ICC rules and state law that predates the Code. The excision in 1978 reflects only disagreement between House and Senate. The trustee belives that this disagreemnt—which blocked the enactment of *any* legislation on the subject—changed existing rules. An unsuccessful attempt to change the law does not by itself change the law in the other direction. E.g., *FTC v. Dean Foods Co.*, 384 U.S. 597, 608-12 (1966); *Wong Yang Sun v. McGrath*, 339 U.S. 33, 47 (1950).

Congress must act by agreement of both chambers, see *INS v. Chadha*, 462 U.S. 919 (1983). If the refusal

of one chamber to accede to the other's proposal were enough to change the law, we would have unicameral action, the same problem that doomed the legislative veto. The most one can say is that a stalemate in 1978 compelled Congress to avoid the subject of this case. Whatever the law was then, it still is. If interline freight balances are "trust funds" under governing law, then giving creditor railroads the status of trust beneficiaries does not violate any principle of equal treatment; the absolute priority rule requires trust beneficiaries to be paid first. If interline creditors do not have interests in trust funds, then giving them a preference would violate the rule that creditors of the same class be treated equally. So the question remains: what type of property interest do interline creditors have?

III

The interline creditors have three possible sources of property rights: federal statutory law, federal interests sufficiently strong to demand the creation of federal common law, and state law. *Butner* holds, and our opinion in *Boston & Maine* reiterates, that state law is the usual source of creditors' rights in bankruptcy cases—exactly as the majority in *Penn Central* held. The district court followed Judge Adams' concurring opinion, however, and so did *In re Ann Arbor R.R.*, 623 F.2d 480 (6th Cir. 1980), concluding that the federal interest in a unified national rail system requires interline balances to be treated as trust funds. We therefore take up federal law first—statute law in Part III, common law in Part IV—before turning to state law in Part V.

The Interstate Commerce Act does not mention interline balances. It is, indeed, mostly silent on relations among carriers. They need not offer interline services or through rates—although the ICC may order the establishment of through routes, 49 U.S.C. § 10705(a)(1). If a carrier proposes to back out it must show that the

cessation is appropriate, and the ICC may suspend the withdrawal and investigate the discontinuation. 49 U.S.C. § 10705(e); *Chesapeake & Ohio Ry. v. United States*, 704 F.2d 373 (7th Cir. 1983).

The ICC has the power to make regulations affecting the question, and these regulations may have the force of law. It has promulgated regulations concerning per diem car charges. Each railroad must accept others' cars, which it must pay for at fixed rates until returning them. *Ex Parte No. 334, Car Service Compensation*, 362 I.C.C. 884 (1980), invoking authority under 49 U.S.C. § 11122. It has not exercised regulatory power, however, with respect to freight or passenger interline balances.

The ICC also has the power to require a uniform system of accounts, see 49 U.S.C. § 11142. Uniform accounting promotes comparative judgments in ratemaking, cf. *ICC v. Goodrich Transit Co.*, 224 U.S. 194 (1912), and the ICC extensively regulates how (some) railroads account for interline balances. 49 C.F.R. §§ 1200-1201. These rules could be a source of property interests in the treatment of interline balances, and we asked for supplemental briefs on this subject.

It turns out that the qualification "some" is important, for the ICC's accounting rules apply only to Class I railroads, lines with revenues exceeding $50 million per year. 49 C.F.R. § 1201(A)(1-1)(a), (c). The Iowa was a Class III railroad (revenues less than $5 million anually) and therefore not governed by the rules; whatever rights they establish among Class I railroads do not apply to the Iowa. Moreover, the accounting rules assist the Iowa's trustee to the extent they apply. The ICC requires railroads to account for interline balances due as "accounts receivable", and for interline balances payable as "accounts payable". 49 C.F.R. § 1201, Rules 705 and 752. The accounting rules do not hint that these funds must be segregated and accounted for as trust

monies. We conclude, therefore, that federal statutes and regulations do not support the interline creditors.

IV

The old National Transportation Policy, 49 U.S.C. preceding § 1 (1976), proclaimed a federal objective of "developing, coordinating, and preserving a national transportation system". Judge Adams wrote against this background. See 486 F.2d at 531 & n.2, 533 (relying on the National Transportation Policy). The Staggers Rail Act of 1980 ended the application of this policy to railroads. The new Rail Transportation Policy, 49 U.S.C. § 10101a, speaks of permitting competition "to the maximum extent possible" (§ 10101a(1)) and "minimiz[ing] the need for Federal regulatory control over the rail transportation system" (§ 10101a(2)). It does not mention promoting a unified national rail system. See *ICC v. Texas*, 107 S. Ct. 787, 793 (1987).

We may assume, however, that shippers' ability conveniently to send freight over a network of connected railroads is an important federal objective, making some co-operation among railroads essential. Dennis W. Carlton & J. Mark Klamer, *The Need For Coordination Among Firms, With Special Reference to Network Industries*, 50 U. Chi. L. Rev. 446 (1983). We also assume, with Judge Adams, that convenience includes the ability to pay a single carrier for the entire movement. Judge Adams believed that treating interline carriers as unsecured creditors would lead each to insist on separate payment, ending the convenient payment system now in use. We part company with him at this step—both because it is not the sort of interest that permits the creation of federal common law and because it is not supported.

A. To say that there is a federal common law governing interests in funds received by rail carriers is to say

that state law is preempted. Until *Butner* many courts believed that bankruptcy permitted federal courts to override state rules when that would be desirable in light of some other objective. *Butner* disapproved of that approach, holding that property rights under state law govern unless there is a contrary federal rule.

A federal rule must be grounded in a concrete federal interest with which the application of state law would interfere. That the dispute involves the interstate transportation network is not enough. See *Miree v. DeKalb County*, 433 U.S. 25 (1977), rejecting the argument that the flow of commercial aviation justifies a national rule concerning airports' responsibility to make it safe for planes to take off. Even when the United States is a party, and multi-state transactions are involved, courts must ordinarily find in state law the rules of decision. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 727-29 (1979).

Private parties stand on both sides of this transaction. Congress has not occupied the field in question. So only a demonstration of substantial conflict between state law and the achievement of an objective defined by federal law would support a conclusion that federal law controls. Extensive regulation is no substitute for a conflict. E.g., *Louisiana Public Service Comm'n v. FCC*, 106 S. Ct. 1890 (1986); *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238 (1984). And it is hard to identify a conflict between state and federal policies even if failure to treat interline balances as trust funds should lead railroads to bill customers separately. This is at most a question of convenience. Small conveniences add up, no doubt, and shippers prefer the current system, but the inconvenience of separate invoicing would not strike at the life blood of interstate commerce.

B. The heart of Judge Adams' position, which the district court adopted, is the belief that treating interline

railroads as unsecured creditors would compel them to deny to customers the convenience of unitary billing. Both Judge Adams and the district judge viewed this as so obvious that argument was unnecessary. We do not find it obvious at all.

Railroads need security, not complete assurance. The system of interline *balances* assures payment of most debts automatically: the Iowa "pays" the Union Pacific by providing transportation services when the Union Pacific is the originating carrier. Only the nets become debts. The risk railroads take is a correspondingly small portion of their revenues.

Railroads have ways to deal with the risk of default by collecting carriers on the balances remaining after the automatic setoffs. One is to scrutinize the creditworthiness of their trading partners, just as firms ordinarily do. Sellers of carpets to department stores are treated as unsecured creditors in department store bankruptcies, but this has not led to the end of trade credit. Sound railroads will do business as usual. Collecting carriers with shaky finances may be required to post bonds, secure letters of credit, or find other ways to assure that they turn over receipts to the railroads that provide part of the transportation. The economy teems with such devices. Standby letters of credit assure payment for billions of dollars of transactions daily. Factors provide the financing for many a thinly capitalized firm. To protect their investments, factors commonly receive incoming sums and apportion them properly. It is easy to imagine the equivalent of a factor in the railroad business receiving the remittances on the Iowa's invoices, then sending the Union Pacific its due and holding the rest for the Iowa's account. Other railroads also could put the Iowa on a cash basis, receiving payment in advance for a fixed quantity of transportation services (which would let the Iowa keep the collection for the entire movement), or could take security interests in

the Iowa's cash and receivables. And, of course, they could do what they largely have done: require other railroads to remit exceptionally quickly, holding to a minimum the exposure at any moment. (More on this below.) These devices work reasonably well. Railroads have employed the one-charge system on interline shipments for at least 100 years, even though until 1973 no court had held that interline balances are trust funds.

We can learn something from the experience of other industries, too. The airline business, the trucking business, the telecommunications business, and several others use interline transfers. A traveler may buy from United Airlines a ticket covering a movement on multiple carriers. A single charge covers a phone call that may start on Ameritech's lines, move over MCI's interstate trunks, and end on Nynex's lines. The carriers apportion among themselves the payments for the joint service. Yet in none of these businesses are the sums paid to the originating carrier treated as trust funds for the subsequent carriers.

Take the airline business. Although no statute requires this, most carriers have interline agreements with others whose routes make interchanges feasible—either individual contracts or through the Airline Clearing House, Inc., an association formed for this purpose. Airlines do this even though bankruptcy has become common (Continental, Braniff, and Frontier are prominent examples). They do so even though the sums one airline has collected for transportation rendered by another are treated as unsecured debts. See *In re Braniff Airways, Inc.*, No. 482-00369 (Bkr. N.D. Tex. Feb. 1, 1983). The problems in collecting from a bankrupt airline pale beside the problems in collecting from bankrupt travel agents. Agents receive billions of dollars from travelers for services furnished by airlines; they stand to all airlines much as the Iowa stands to the Union Pacific. *In re Morales Travel Agency*, 667 F.2d 1069 (1st Cir. 1981), holds that the claims of the airlines are unsecured debts of travel agencies. Yet air-

lines go on dealing with travel agents, and travelers reap the benefits of convenience. See also, e.g., *In re Shulman Transport Enterprises*, 33 B.R. 383 (S.D.N.Y. 1983), affirmed, 744 F.2d 293 (2d Cir. 1984), holding that the relation between air freight forwarding services and the airlines supplying the transportation is that of debtor-creditor.

The motor carrier business looks much the same. Motor carriers may enter into joint and through route agreements, 49 U.S.C. § 10703, and the ICC may prescribe them when appropriate. The originating or destination carrier collects the price of the entire movement and remits the divisions to other carriers. Courts treat sums owing to other carriers as unsecured debts. E.g., *In re Penn-Dixie Steel Corp.*, 10 B.R. 878 (S.D.N.Y. 1981); *Allied Van Lines, Inc. v. SBA*, 507 F. Supp. 397 (E.D. Mo. 1980), affirmed, 667 F2d 751 (8th Cir. 1982). The lack of trust status—and the fact that motor carriers face bankruptcy risks at least as great as travel agents, airlines, and railroads—has not prevented motor carriers from offering customers the convenience of a single bill per shipment.

The parties have not called to our attention may business other than railroads in which even one court has treated interline balances as trust funds. They also have not called to our attention, and we could not find, an industry in which the treatment of interline balances as unsecured debts has led to inconvenience to customers. Cf. *CFTC v. Heritage Capital Advisory Services, Inc.*, 823 F.2d 171 (7th Cir. 1987) (money deposited with a broker for transfer to a manager is not held in trust for the customer). This should not be a great surprise. If customers value the convenience of paying by a single bill, firms will strive to supply their desires. Those that figure out how to do so at least cost will flourish.

This may seem to overlook the cost. If the railroad business swallows losses in order to provide convenient

billing, the customer pays in the end. Perhaps one could argue that the financial health of the railroad business depends on being able to collect interline balances quickly. This is not a complete view, however. Railroads are on both sides of these transactions. If some railroad is more secure, another is less so. If interline creditors always get 100¢ on the dollar, then other creditors (suppliers of fuel, equipment, and labor first among them) get less. They perceive the risks as greater and must do more to protect themselves—take security interests, charge higher interest, and so on. Shippers must pay these alternative costs, too. In other words, the risk of failure is part of the business. If railroads insulate some of their creditors (interline roads) from the risk, they expose other creditors to more of it; in the end, someone bears the whole risk, and shippers pay the full cost. There is no panacea in making interline creditors better off. We therefore do not agree with Judge Adams that giving interline creditors priority claims on the funds of bankrupt railroads is essential to the preservation of a national transportation system. Perhaps it would help; we express no view on the long run merit of the system. It is not so *clearly* important that a federal court may create federal common law to trump the state law that governs competing claims to a debtor's funds.

V

The opinion of the court in *Penn Central* held that interline freight balances between Class I railroads are held in trust under state law. The railroad creditors in this case rely on that holding. The Third Circuit did not say *which* state's law; neither do the railroad creditors here. The railroads apparently are content to rely on a "general common law"—as if Justice Holmes had never observed that there is no

> transcendental body of law outside of any particular State but obligatory within it unless and until

> changed . . . . Law is a word used with different meanings, but law in the sense in which courts speak of it today does not exist without some definite authority behind it. The common law so far as it is enforced in a State, whether called common law or not, is not the common law generally but the law of that State existing by the authority of that State without regard to what it may have been in England or anywhere else.

Black and White Taxicab & Transfer Co. v. Brown and Yellow Taxicab & Transfer Co., 276 U.S. 518, 533-34 (1928) (Holmes, J., dissenting), overruled by *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). See also *Guaranty Trust Co. v. York*, 326 U.S. 99, 101-03 (1945). The law applicable to this case under the conflicts rules of Illinois, in which the federal court sits, may be different from the trust law of Pennsylvania. The parties are free to agree on substantive law within limits, however, and have treated this as a subject on which state laws do not differ. The federal courts refer to the "whole law" of the forum state, *Klaxon v. Stentor*, 313 U.S. 487 (1941). When (as here) the parties do not say that the forum state's conflict-of-laws rules require the application of another state's substantive law, this means we must apply the forum state's substantive law. *Casio, Inc. v. S.M. & R. Co.*, 755 F.2d 528, 531 (7th Cir. 1985). The parties have done little to enlighten us about Illinois law, however, turning instead as the Third Circuit did to the *Restatement (Second) of Trusts* (1957).

Railroads use two principal methods to settle interline balances. Under the bill-and-voucher method, which the Iowa used for most of its existence, the destination carrier computes the portions of the total charge each railroad involved in the movement is entitled to receive. (The originating carrier may collect the shipping charges from the shipper, or the destination carrier from the consignee; in either case, the destination carrier computes the divi-

sions of revenue, because the final waybill shows the complete movement, which could change en route.) The destination carrier sends statements of entitlements called "abstracts" to all other railroads involved by the 18th of the month after the waybills were issued. The railroads send each other monthly statements of sums received for movements performed by others, by the 20th of the month (that is, almost immediately after receiving the abstracts). Railroads offset these statements, and the creditor railroad sends a bill for the balance. The debtor railroad pays this bill as it does others. It does not maintain segregated accounts. The Iowa remitted 60 or more days after receiving its bills, without protest by the creditor railroads.

The 28 Class I railroads use a different methods, prescribed by the Association of American Railroads. Eighty or so Class II and III railroads participate in this system voluntarily (while about 420 small railroads use the bill-and-voucher system). After the circulation of the abstracts by the 18th of the month and the statements of net balances by the 20th, the nets are subject to immediate collection. Each railroad participating in the AAR's system has a microencoded plastic card for each of the others. The creditor line uses the card to prepare a sight draft against the debtor's bank account. The creditor road puts this draft into the bank settlement system just as if it were a check signed by the debtor railroad. The debtor's bank pays in the ordinary course. The balance thus is paid instantly without any action by the debtor line. At the time of the *Penn Central* case, the Class I railroads used a system of sight drafts minus the microencoded cards; then, as now, the creditor line took charge of obtaining payment from the debtor's banks.

Penn Central dealt with the payment of balances for May 1970, the month before that railroad entered bankruptcy. The petition was filed on June 21, 1970, just as sight drafts for May were being received. The Penn Cen-

tral's banks dishonored drafts for about $15 million received on or after June 22, and the creditor railroads asked the bankruptcy court to order payment. Relying on the *Restatement*, the Third Circuit concluded that the Penn Central held this $15 million in trust for the other railroads and ordered immediate payment.

It recognized that under § 2 of the *Restatement*—and so far as we know the law of all 50 states—a trust is a contractual arrangement and therefore depends on the parties' agreement. See *La Throp v. Bell Federal Savings & Loan Ass'n*, 68 Ill. 2d 375, 370 N.E.2d 188 (1977). The railroads have not expressly declared interline balances to be trust funds, and they do not use some of the customary indicia of trust, such as segregated accounts. The Iowa regularly invested its collections and kept the proceeds, remitting only the principal to the interline carriers. And the shippers, potential settlors of such trusts, not only have no pertinent intent but also do not know how the railroads handle the funds (or much care, so long as the goods are delivered). There is no express trust.

Penn Central concluded that agreement may be implied as well as express. The AAR's system of prompt settlement and immediate payment amounted to an implied trust agreement, the court held. The AAR's settlement system treats each railroad as a collecting agent for the others. The funds may be commingled by the collecting railroad, but they are at the disposal of the creditor railroad with the power to write sight drafts. *Penn Central* thought it significant that the funds were payable without interest, 486 F.2d at 524, and insignificant that they could be commingled, *id.* at 525. The magnitude of the daily collections, and the number of interline roads (the Penn Central dealt with more than 300), made segregation to accounts impractical, the court thought.

We are sympathetic to the contention that the AAR's accounting rules, coupled with the system of sight drafts

that give creditor lines effective dominion over the funds, is the practical equivalent of a declaration of trust. The trouble from the interline creditors' perspective is that the Iowa did not participate in the AAR's system for more than a few months. During the period at issue in this case it used the bill-and-voucher system, under which interline railroads had no more control over payment than did the Iowa's suppliers of diesel fuel. *Penn Central* expressly distinguished such a case. *Southern Ry. v. United States*, 306 F.2d 119, 124-25 (5th Cir. 1962), declined to accord priority treatment to interline claims by the Southern against the Tallulah Falls Ry. when Southern submitted a bill and waited for more than a year to be paid, without demanding the segregation of funds. The Third Circuit viewed this decision as consistent with its own (486 F.2d 525-26); it was apparently cases like *Southern* that led Judge Adams to urge the creation of federal common law to protect interline creditors who fail to protect themselves.

The Iowa's case is much closer to *Southern* than to *Penn Central*. The Iowa did not allow other railroads to write sight drafts against its accounts. It declined to pay interline balances until presented with both an abstract of waybills and an invoice; when billed, it paid slowly (60-90 day delays were common). The other lines did not respond by insisting that the Iowa segregate its collections for their benefit; so far as the record shows, they did not even protest the slow payment. When the Iowa failed, it had at least six months of interline balances outstanding. It is difficult to resist the impression that the Iowa treated other railroads as trade creditors, and that they acquiesced in this treatment. This is the opposite of a manifest intent to create a trust, and without such an intent there is no trust. *Restatement* § 24 comment *c*: "It is essential to the creation of a trust that the settlor should manifest by some external expression his final and definitive intention that a trust should arise."

The "external expression" is important to other creditors, who need objective signs in order to determine their own priority to the assets ostensibly held by their trading partners.

Although the Iowa did not hold the receipts in an express trust, perhaps it held them as a resulting trust. Under *Restatement* § 440, "[w]here a transfer of property is made to one person and the purchase price is paid by another, a resulting trust arises in favor of the person by whom the purchase price is paid". See *In re Wilson*, 81 Ill. 2d 349, 410 N.E.2d 23 (1980). The paradigm is the sale of a cow from A to B, with B paying but C temporarily in possession. C holds the cow in trust for B. Or A sells stock to B, which places the certificates with C to be held in street name; C is trustee for B. *Restatement* § 440 Illustration 1. Perhaps one could say that the Union Pacific transferred "services" to the Iowa, which collected the price; but on this reading the Iowa holds the transportation services in trust for shippers. The parties have not called to our atttention, and we have not found, any case treating as a "resulting trust" the money received from a customer when the seller was blending goods or services of several suppliers and selling them as a unit. "A resulting trust . . . seeks to carry out a donative intention rather than to thwart a wicked scheme." *American National Bank & Trust Co. v. United States*, 832 F.2d 1032, 1035 (7th Cir. 1987) (Illinois law). No one argues that the shippers or consignees—the settlors in a resulting-trust approach—had any particular intent about how the Iowa would apportion the shipping charges. They cared only that they receive the transportation they paid for, as they did. Since in Illinois the "burden of proof is upon the party seeking to establish a resulting trust and the evidence must be clear, convincing and unmistakable", *Wilson*, 410 N.E.2d at 27, this approach does not yield the railroads much mileage. The air and truck transportation cases we discussed

above, those closest in principle to the railroad case, all reject the argument that the collecting airline, trucker, or travel agent holds the funds in trust for the carriers providing the service.

The last possibility we need consider is the "constructive trust" under the *Restatement of Restitution* § 160 (1937), providing that a trust arises "[w]here a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it." The interline railroads mention but do not seriously pursue this possibility. A constructive trust usually depends on a fraudulent act to obtain control of the assets, see *In re General Coffee Corp.*, 828 F.2d 699 (11th Cir. 1987) (Florida law); *Fender v. Yagemann*, 29 Ill. 2d 205, 210, 193 N.E.2d 794 (1963); and the Iowa put its hands on this money legitimately. There could be a decent claim of unjust enrichment if we had to decide whether the Iowa's stockholders or the interline railroads should get the money remaining in the Iowa's coffers; it would unjustly enrich the stockholders to receive this money. But that is not the problem. The question is whether the interline railroads get all of the money and the suppliers of diesel fuel (and tort creditors) none; or whether all creditors share the inadequate funds. The suppliers of diesel fuel will not be "unjustly enriched" if they receive 70% of their debts (without interest). All of the Iowa's creditors have supplied valuable goods and services; all have been stiffed. No case of which we are aware employs the idea of the "constructive trust" to settle priorities among bona fide business suppliers. Several have rejected this approach. E.g., *In re North American Coin & Currency, Ltd.*, 767 F.2d 1573 (9th Cir. 1985); *In re First Capital Mortgage Loan Corp.*, 60 B.R. 915 (Bkr. D. Utah 1986). The sellers of diesel fuel might as well argue that a constructive trust runs in *their* favor. What we have is a breach of contracts, which is not enough to create a constructive trust, *id.* at § 108.

The Iowa did not expressly declare that it held funds in trust; it did not segregate its funds; it did not accede to the AAR's system of sight drafts that would put funds at the disposal of the interline railroads; these railroads did not protest the Iowa's glacial payment. Nothing in the way the Iowa did business would have alerted other creditors that the funds ostensibly in its control were held in trust. We therefore conclude that the interline balances are general, unsecured debts of the Iowa.

REVERSED AND REMANDED

RIPPLE, *Circuit Judge*, concurring. I join the judgment and the opinion of the court. I write separately to emphasize that, as the court notes explicitly in the last several sentences of Part IV, our holding is based on the policy choices Congress has made with respect to national transportation policy. Our views as to whether this policy is an appropriate one are irrelevant to a resolution of the legal question before us.

A true Copy:

Teste:

Clerk of the United States Court of
Appeals for the Seventh Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

March 18, 1988

Before

HON. FRANK H. EASTERBROOK, *Circuit Judge*
HON. KENNETH F. RIPPLE, *Circuit Judge*
HON. ROBERT A. GRANT, *Senior District Judge**

Nos. 86-2760 and 87-1082

IN THE MATTER OF: IOWA RAILROAD COMPANY,
Debtor.

UNION PACIFIC RAILROAD COMPANY, *et al.*,
Plaintiffs-Appellees,

v.

TERRY F. MORITZ, TRUSTEE OF IOWA RAILROAD COMPANY,
Defendant-Appellant.

Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 85 C 4463—John F. Grady, *Chief Judge*

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* The Honorable Robert A. Grant, of the Northern District of Indiana, sitting by designation.

ORDER

Plaintiffs-Appellees filed a petition for rehearing and suggestion of rehearing en banc on March 8, 1988. No judge in regular active service has requested a vote on the suggestion of rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED. Circuit Judge Cummings did not participate in the consideration or decision of this case.

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 84 B 13968

HON. JOHN F. GRADY

IN RE: IOWA RAILROAD COMPANY,
AN IOWA CORPORATION,
Debtor.

Adversary No. 85 C 04463

UNION PACIFIC RAILROAD COMPANY, A UTAH CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, A DELAWARE CORPORATION, THE WESTERN PACIFIC RAILROAD COMPANY, A DELAWARE CORPORATION, AND SPOKANE INTERNATIONAL RAILROAD COMPANY, A WASHINGTON CORPORATION,
Plaintiff,

v.

IOWA RAILROAD COMPANY,
Debtor,

and

TERRY F. MORITZ, ITS TRUSTEE,
Defendants.

FINAL JUDGMENT ORDER

This is an adversary proceeding filed by Union Pacific, Missouri Pacific, The Western Pacific and Spokane In-

ternational Railroad Companies (hereinafter Plaintiffs or Union Pacific) against the Iowa Railroad Company, Debtor (hereinafter IRRC) and its Trustee. The matter is before the court on Plaintiff's Rule 56(a) motion for summary judgment on its Complaint. The issue presented is whether or not railroad interline freight revenue due and owing the Plaintiffs and collected by IRRC are held in trust by IRRC for the benefit of Union Pacific.

I find that there is no genuine issue as to any material fact with respect to $1,451,729.04 claimed by Union Pacific.[1] I hold that Union Pacific is entitled to judgment as a matter of law and that IRRC holds that amount in trust for Union Pacific as further explained in this order. The basis for my decision follows:

UNCONTESTED FACTS

IRRC was incorporated August 21, 1981. It began railroad operations on or about October 14, 1981. As of June, 1982, IRRC was operating over not more than 510.8 miles of non-owned track. Little more than three years after its startup, on November 2, 1984, IRRC filed its petition in this Court under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101 *et. seq.* (the Code).

In 1983, IRRC had total assets of $1,704,473.89 and had no temporary cash investments. In that year, IRRC lost $193,804.94 on railroad operations. In 1984, IRRC had total assets of $4,438,202.82 including $2,236,700.39 in cash or cash equivalents. In that year IRRC also purchased certain locomotives for $864,000 cash. In that year IRRC earned only $306,322.77 on railroad operations.

In 1983 and 1984, IRRC accumulated an interline freight balance due and owing Plaintiffs of over $1.4

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[1] A dispute exists with respect to the additional sum of $22,575.70 claimed by Union Pacific.

million. At the time IRRC filed its petition in this case, it owed other railroads, including Union Pacific, roughly $3.9 million in interline freight revenues. The Trustee now holds roughly $2.8 million in United States Treasury bills. The amount of the Treasury bills, less compounded interest included therein, represents interline freight revenues earned by those railroads, but collected by IRRC or the Trustee.[2]

Interline freight revenue is generated by rail movement of freight over the lines of more than one railroad. Railroads participating in such movement are generally referred to as interline railroads. Each interline railroad earns a proportionate share of revenue for the whole movement; however, the shipper pays only the origin or destination carrier for the whole movement.[3]

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[2] Subsequent to the Court's announcement of its ruling, the parties submitted an accounting based upon the Trustee's Schedule of Receipts and Disbursements for October, 1985, which was previously filed with this Court, identifying such monies as (1) Treasury bill purchased 10/31/85 in the amount of $1,203,425.00, (2) Treasury bill purchaseed 6/20/85 in the amount of $289,571.00, (3) Treasury bill purchased 8/15/85 in the amount of $577,709.00, (4) Treasury bill purchased 9/19/85 in the amount of $626,142.83, and (5) Money Market account no. 8875502 at the Northern Trust Bank, which total in the aggregate approximately $2,872,049, including interest. This amount does not include that money subject to dispute between IRRC and Iowa Interstate Railroad, Ltd. now pending in this case.

The parties have not yet determined or submitted to the Court which portions of the Treasury bills and Money Market account represent interest earned on the interline freight revenues. Nor have the parties presented for decision by this Court whether or not such interest included in or earned by these Treasury bills, or other assets held by the Trustee such as the locomotives purchased in 1984, are subject to the trust claims of the interline railroads.

[3] For prepaid interline shipments, the origin interline railroad will collect from the shipper the entire revenue generated by the movement, including the proportionate share of revenue of other interline railroads. For collect shipments, the destination interline railroad collects the entire revenue.

The interline railroads account to each other on a monthly basis for interline freight revenues collected for each other.[4] Payment in settlement of interline freight revenue accounts is by sight draft or voucher. This manner of settling interline freight revenue accounts is necessary to ensure the smooth interchange of interline traffic and to avoid the situation of a shipper having to make separate arrangements with each interline railroad participating in an interline movement.

Union Pacific and IRRC settled interline freight revenue accounts in this manner.[5] To the parties' knowledge, it is the only manner of settling interline freight revenue accounts. The procedure for settling interline freight revenue accounts is specifically set out in the accounting rules of the Association of American Railroads. Union Pacific is a member of the AAR, however, IRRC is not.

DISCUSSION

Union Pacific alleges that the law established in the *Trust Funds Case* [*In Re Penn Central Transportation Company*, 486 F.2d 519 (3d Cir. 1973)] and its progeny dictate that interline freight revenues collected by IRRC and owed to Union Pacific are held in trust by IRRC for the benefit of Union Pacific. The Trustee counters that Union Pacific is a mere creditor of IRRC and that interline freight revenues collected by IRRC are IRRC's money, to be used to reorganize and to pay all its creditors.

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[4] To settle interline freight revenue accounts, the collecting railroad collects the entire interline revenue generated from interline traffic interchanged with the collecting railroad for the prior month and distributes to each other participating interline railroad its proportionate share of that interline revenue.

[5] IRRC commonly co-mingled interline freight revenues it collected. Union Pacific never charged IRRC interest on the freight revenue balance due Union Pacific from IRRC. IRRC paid its interline freight revenue accounts by the voucher method.

Specifically, the Trustee contends: (1) that the requirements of a trust have not been met with respect to the interline freight revenues here; (2) that the logic of the *Penn Central* case does not apply here; (3) that since IRRC is not a member of the AAR, *Penn Central* does not apply here; and (4) that *Penn Central* was rejected by Congress when it enacted the Code. I find the Trustee's contentions to be without merit for the following reasons.

Primarily, there is no dispute that these interline freight revenues were earned by Union Pacific. IRRC did nothing to earn this money. It simply acted as a collection agent for Union Pacific due to the exigencies of the interline freight revenue collection process. No creditor of IRRC can possibly make any reasonable argument that it has a claim on these interline funds. No service rendered or goods delivered by any creditor of IRRC had anything whatsoever to so with the generation of these interline funds. These facts weigh against the existence of a debtor/creditor relationship respecting IRRC and these monies.

The Trustee has nonetheless spent considerable effort to persuade me that the requirements of a trust are lacking here. In my view, however, the proper resolution of this matter is as stated by Adams, J., in his concurring opinion in the Third Circuit Court of Appeals decision in the *Penn Central* case. At 486 F.2d 533, Judge Adams said:

> "Rather than merely invoke the hoary principles of trust law to settle this case, I would treat the problem of interline freight and passenger accounts as a *sui generis* matter. Having perceived Congress' interest in creating and maintaining a viable interline rail system, it would be appropriate to hold that, even in the *absence* of anything formally resembling a 'trust,' the interlines are entitled to a preferred position with respect to freight and passenger rev-

enues owed them by a railroad in reorganization. [emphasis in original]"

Whether or not the traditional requisites of a trust are present, then, is not the significant consideration. Rather, the result here is dictated by the necessity of the situation:

> "There is no statutory compulsion for interconnecting rail carriers to utilize any particular method of collecting fares and freight charges for a through-routed shipment. But, as a practical matter, only one such method is feasible. That is for a single carrier—either the originating or the destination carrier—to collect the entire fare, and then remit to the interline carriers their pro rata portions. This arrangement is apparently subscribed to by the entire industry, and is incorporated in the rules of the Association of American Railroads. A departure from this procedure—for example, insistence by each interline carrier upon immediate payment by the shipper—might well undermine the entire system of interline rail transportation. At a minimum, it would greatly impede the smooth and efficient functioning of the through-route network." 486 F.2d 519 at 532.

Other courts that have addressed this identical question have consistently followed Judge Adams' logic. As stated by the 6th Circuit Court of Appeals in *Matter of Ann Arbor Railroad Company*, 623 F.2d 480 (6th Cir. 1980):

> "We are persuaded by the reasoning of the court in the Trust Funds Case and the concurring opinion of Judge Adams in which Circuit Judge Weis joined, which fully considered and appropriately answered the various contentions of the bankruptcy Trustee. * * * We find no logic in the contention that one bankrupt railroad may retain funds belonging to

> another interline railroad, whether or not in bankruptcy, which the collecting carrier was required to pay under the established practice and procedure required by the Interstate Commerce Commission, the Regional Railway Organization Act and the rules of the Association of American Railroads." 623 F.2d 480 and 482.

The Trustee argues that since IRRC was not a member of the AAR the above rational does not apply. I am not persuaded. Regardless of membership in the AAR, IRRC was acting as collection agent for Union Pacific due to the exigencies of the interline freight revenue collection process. Whether or not IRRC was a member of the AAR, then, is of no consequence here.

I find nothing in the Code which prevents or could be interpreted as having been intended to prevent a declaration that these interline freight revenues are held in trust by IRRC for Union Pacific. Moreover, as Judge Adams stated, to the extent the vindication of any particular statute is at issue, it is the vindication of the Interstate Commerce Act which is paramount.

There is simply no sensible argument that can be made that these interline freight revenues are property of IRRC. Principles of common sense and elemental justice require that the railroad which earned this money be declared to be its owner. Union Pacific should not be relegated to the status of a mere general creditor hoping to share some small portion of the money it earned with its capital and its labor. Rather, Union Pacific is entitled to be treated as a beneficiary with respect to these interline freight revenues which I hold are trust funds in the hands of IRRC.

CONCLUSION

Union Pacific earned these interline freight revenues. The exigencies of the interline freight revenue collection process made it a trust beneficiary with respect to this

money. This result is not affected by the Code or by the status of the parties' membership in the AAR. Principles of common sense and elemental justice dictate that this money is held in trust by IRRC for the benefit of Union Pacific.

IT IS THEREFORE ADJUDGED, ORDERED AND DECREED that Union Pacific is entitled to $1,451,729.04 in interline freight revenues; that the Trustee holds certain funds, consisting of at least the principal amount of the Treasury bills and money market account identified above, in trust for the benefit of Union Pacific to pay such interline freight amounts; that the Trustee shall pay said trust funds pro rata to Union Pacific and other similarly situated interline railroads that hold duly proved and allowed claims for interline freight revenues.

The parties are not precluded by this judgment from determining whether or not any other property now in possession of or hereafter acquired by the Trustee is impressed with a trust for the benefit of Union Pacific or other interline railroads. Actual distribution of funds to Union Pacific and other interline railroads shall be pursuant to further order of the Court.

Pursuant to F.R.C.P. 54(b), the Court further finds that there is no just reason for delay and expressly directs that final judgment be and hereby is entered in favor of Plaintiffs as aforesaid.

SO ORDERED.

ENTER: /s/ John F. Grady
United States District Judge

Dated: December 31, 1985

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 84 B 13968

IN RE: IOWA RAILROAD COMPANY, AN IOWA CORPORATION,
Debtor.

No. 85 C 4463

UNION PACIFIC RAILROAD COMPANY, *et al.*,
Plaintiffs,

v.

IOWA RAILROAD COMPANY

and

TERRY F. MORITZ, ITS TRUSTEE,
Defendants.

ORDER

In the "Final Judgment Order" of December 31, 1985, I found that the sum of $1,451,729.04 which the Trustee is holding in Treasury Bills and a money market account constitutes, in its entirety, interline freight revenues (and interest thereon) which are subject to the trust in favor of the interline carriers. Upon further reflection, I am not certain there was a sufficient factual basis for that finding. At the time I entered the order, I did not take account of the possibility that some portion of those

funds may have been derived from sources other than interline shippers.

It may be that there was an adequate factual basis for finding all of the funds to be subject to the trust, and, if that is so—or, if need be, such showing can be made by additional evidence—the finding in the order of December 31, 1985, will not be changed. To eliminate any doubt about the accuracy of the finding, however, I believe the proper course is for the court to retain jurisdiction to modify the order in the event it should appear that some portion of the $1,451,724.04 has been derived from sources other than interline revenues. Accordingly, the "Final Judgment Order" of December 31, 1985, is modified by deleting therefrom the final paragraph on page 10, wherein I certified the order for an interlocutory appeal pursuant to Fed. R. Civ. P. 54(b). Consistent with this change, the word "Final" is deleted from the title of the order.

DATED: Feb. 20, 1986

ENTER: /s/ John T. Grady
United States District Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 85 C 4463
(84 B 13968)

UNION PACIFIC RAILROAD COMPANY, *et al.*,
Plaintiffs,

v.

IOWA RAILROAD COMPANY AND TERRY F. MORITZ,
ITS TRUSTEE,
Defendants.

ORDER

The motion of Terry F. Moritz, Trustee of the Iowa Railroad Company, to reconsider the Judgment Order dated December 31, 1985, and modified by an Order dated February 20, 1986, is denied. The court adheres to its view that the interline freight revenues are trust funds. *Boston & Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562 (7th Cir. 1986), is factually distinguishable. That case did not involve interline freight revenues collected from shippers by one railroad for services rendered by another railroad. Rather, it involved the charges made between railroads for services rendered to each other.

The court agrees with plaintiffs that this case is governed by the conclusive presumption that a trustee spends his own funds first, before encroaching upon a trust fund. Therefore, it is not necessary for plaintiffs to undertake

the impossible task of tracing specific interline freight revenues.

The parties have agreed that plaintiffs have no claim to the $22,575.00 referred to in footnote 1 on page 2 of the Order, and therefore the Order is modified to delete that footnote.

DATED: October 15, 1986

ENTER: /s/ John T. Grady
United States District Judge

APPENDIX E

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 84 B 13968

HON. JOHN F. GRADY

IN RE: IOWA RAILROAD COMPANY, AN IOWA CORPORATION,
Debtor.

Adversary No. 85 C 04463

UNION PACIFIC RAILROAD COMPANY, A UTAH CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, A DELAWARE CORPORATION, THE WESTERN PACIFIC RAILROAD COMPANY, A DELAWARE CORPORATION, AND SPOKANE INTERNATIONAL RAILROAD COMPANY, A WASHINGTON CORPORATION,
Plaintiff,

v.

IOWA RAILROAD COMPANY,
Debtor,

and

TERRY F. MORITZ, ITS TRUSTEE,
Defendants.

FINAL JUDGMENT ORDER

This is an adversary proceeding filed by Union Pacific, Missouri Pacific, The Western Pacific and Spokane International Railroad Companies (hereinafter "Plaintiffs" or "Union Pacific") against the Iowa Railroad Company,

Debtor (hereinafter "IRRC") and its Trustee. The matter is before the court on Plaintiff's Rule 56(a) motion for summary judgment on its Complaint. The issues presented are: (1) whether or not railroad interline freight revenues due and owing the Plaintiffs and collected by IRRC are held in trust by IRRC for the benefit of Union Pacific and other interline railroads; and (2) whether Union Pacific has sufficiently identified assets in Trustee's possession as interline trust funds.

I find that there is no genuine issue as to any material fact with respect to $1,451,729.04 claimed by Union Pacific. I hold that interline freight is a trust fund in the hands of the collecting railroad. I further hold that Union Pacific has sufficiently identified certain assets in Trustee's possession as interline trust funds. Union Pacific is therefore entitled to judgment on its Complaint as a matter of law as further explained in this order. The bases for my decision follow:

UNCONTESTED FACTS

IRRC was incorporated August 21, 1981. It began railroad operations on or about October 14, 1981. As of June, 1982, IRRC was operating over not more than 510.8 miles of non-owned track. Little more than three years after its startup, on November 2, 1984, IRRC filed its petition in this Court under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (the Code).

In 1983, IRRC had total assets of $1,704,473.89 and had no temporary cash investments. In that year, IRRC lost $193,804.94 on railroad operations. In 1984, IRRC had total assets of $4,438,202.82 including $2,236,700.39 in cash or cash equivalents. In that year IRRC also purchased certain locomotives for $864,000 cash. In that year IRRC earned only $306,322.77 on railroad operations.

In 1983 and 1984, IRRC accumulated an interline freight balance due and owing Plaintiffs of over $1.4 million. At the time IRRC filed its petition in this case, it owned other railroads, including Union Pacific, roughly $3.9 million in interline freight revenues. As of March 19, 1986, IRRC or the Trustee had collected all but $148,141.68 of the interline freight revenue from shippers. No creditor has filed any claim for money loaned to IRRC. The Trustee now holds roughly $2.9 million in United States treasury bills and other cash equivalents.[1]

Interline freight revenue is generated by rail movement of freight over the lines of more than one railroad. Railroads participating in such movement are generally referred to as interline railroads. Each interline railroad earns a proportionate share of revenue for the whole movement; however, the shipper pays only the origin or destination carrier for the whole movement.[2]

The interline railroads account to each other on a monthly basis for interline freight revenues collected for

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[1] The money is more specifically identified as follows: (1) treasury bill purchased 5/1/86 in the amount of $1,250,152.62; (2) treasury bill purchased 6/26/86 in the amount of $43,695.37; (3) treasury bill purchased 8/18/86 in the amount of $695,520.62; (4) treasury bill purchased 9/18/86 in the amount of $982,780.50 (these treasury bills and all accumulations and proceeds thereof are collectively referred to as the "Treasury Bills"); and (5) Money Market account no. 8875502 at the Northern Trust Bank, which total in the aggregate approximately $2,977,750. To be segregated from this account is $64,312.19 and accrued interest thereon claimed by the Trustee as proceeds of sales of pre-petition hard assets. Additionally, there are other hard assets of the estate claimed by the Plaintiffs as "substituted trust assets." This order does not address ownership of the $64,312.19 and accrued interest claimed by the Trustee, or the substituted trust assets.

[2] For prepaid interline shipments, the origin interline railroad will collect from the shipper the entire revenue generated by the movement, including the proportionate share of revenue of other interline railroads. For collect shipments, the destination interline railroad collects the entire revenue.

each other.[3] Payment in settlement of interline freight revenue accounts is by sight draft or voucher. This manner of settling interline freight revenue accounts is necessary to ensure the smooth interchange of interline traffic and to avoid the situation of a shipper having to make separate arrangements with each interline railroad participating in an interline movement.

Union Pacific and IRRC settled interline freight revenue accounts in this manner.[4] To the parties' knowledge, it is the only manner of settling interline freight revenue accounts. The procedure for settling interline freight revenue accounts is specifically set out in the accounting rules of the Association of American Railroads. Union Pacific is a member of the AAR, however, IRRC is not.

DISCUSSION

Union Pacific alleges that the law established in the *Trust Funds Case* [*In Re Penn Central Transportation Company*, 486 F.2d 519 (3d Cir. 1973)] and its progeny dictate that interline freight revenues collected by IRRC and owed to Union Pacific are held in trust by IRRC for the benefit of Union Pacific. The Trustee counters that Union Pacific is a mere creditor of IRRC and that interline freight revenues collected by IRRC are IRRC's money, to be used to reorganize and to pay all its creditors.

Specifically, the Trustee contends: (1) that the requirements of a trust have not been met with respect to

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[3] To settle interline freight revenue accounts, the collecting railroad collects the entire interline revenue generated from interline traffic interchanged with the collecting railroad for the prior month and distributes to each other participating interline railroad its proportionate share of that interline revenue.

[4] IRRC commonly co-mingled interline freight revenues its collected. Union Pacific never charged IRRC interest on the freight revenue balance due Union Pacific from IRRC. IRRC paid its interline freight revenue accounts by the voucher method.

the interline freight revenues here; (2) that the logic of the *Penn Central* case does not apply here; (3) that since IRRC is not a member of the AAR, *Penn Central* does not apply here; (4) that *Penn Central* was rejected by Congress when it enacted the Code; and (5) that Union Pacific has not sufficiently identified this money as interline trust funds. I find the Trustee's contentions to be without merit for the following reasons.

Primarily, there is no dispute that these interline freight revenues were earned by Union Pacific. IRRC did nothing to earn this money. It simply acted as a collection agent for Union Pacific due to the exigencies of the interline freight revenue collection process. No creditor of IRRC can possible make any reasonable argument that it has a claim on these interline funds. No service rendered or goods delivered by any creditor of IRRC had anything whatsoever to do with the generation of these interline funds. These facts weigh against the existence of a debtor/creditor relationship respecting IRRC and these monies.

The Trustee has nonetheless spent considerable effort to persuade me that the requirements of a trust are lacking here. In my view, however, the proper resolution of this matter is as stated by Adams, J., in his concurring opinion in the Third Circuit Court of Appeals decision in the *Penn Central* case. At 486 F.2d 533, Judge Adams said:

> "Rather than merely invoke the hoary principles of trust law to settle this case, I would treat the problem of interline freight and passenger accounts as a *sui generis* matter. Having perceived Congress' interest in creating and maintaining a viable interline rail system, it would be appropriate to hold that, even in the *absence* of anything formally resembling a 'trust,' the interlines are entitled to a preferred position with respect to freight and passenger rev-

enues owed them by a railroad in reorganization. [emphasis in original]"

Whether or not the traditional requisites of a trust are present, then, is not the significant consideration. Rather, the result here is dictated by the necessity of the situation:

> "There is no statutory compulsion for interconnecting rail carriers to utilize any particular method of collecting fares and freight charges for a through-routed shipment. But, as a practical matter, only one such method is feasible. That is for a single carrier—either the originating or the destination carrier—to collect the entire fare, and then remit to the interline carriers their pro rata portions. This arrangement is apparently subscribed to by the entire industry, and is incorporated in the rules of the Association of American Railroads. A departure from this procedure—for example, insistence by each interline carrier upon immediate payment by the shipper—might well undermine the entire system of interline rail transportation. At a minimum, it would greatly impede the smooth and efficient functioning of the through-route network." 486 F.2d 519 at 532.

Other courts that have addressed this identical question have consistently followed Judge Adams' logic. As stated by the 6th Circuit Court of Appeals in *Matter of Ann Arbor Railroad Company*, 623 F.2d 480 (6th Cir. 1980):

> "We are persuaded by the reasoning of the court in the Trust Funds Case and the concurring opinion of Judge Adams in which Circuit Judge Weis joined, which fully considered and appropriately answered the various contentions of the bankruptcy Trustee. * * * We find no logic in the contention that one bankrupt railroad may retain funds belonging to

> another interline railroad, whether or not in bankruptcy, which the collecting carrier was required to pay under the established practice and procedure required by the Interstate Commerce Commission, the Regional Railway Organization Act and the rules of the Association of American Railroads." 623 F.2d 480 and 482.

The Trustee argues that since IRRC was not a member of the AAR the above rational does not apply. I am not persuaded. Regardless of membership in the AAR, IRRC was acting as collection agent for Union Pacific due to the exigencies of the interline freight revenue collection process. Whether or not IRRC was a member of the AAR, then, is of no consequence here.

I find nothing in the Code which prevents or could be interpreted as having been intended to prevent a declaration that these interline freight revenues are held in trust by IRRC for Union Pacific. Moreover, as Judge Adams stated, to the extent the vindication of any particular statute is at issue, it is the vindication of the Interstate Commerce Act which is paramount.

There is simply no sensible argument that can be made that these interline freight revenues are property of IRRC. Principles of common sense and elemental justice require that the railroad which earned this money be declared to be its owner. Union Pacific should not be relegated to the status of a mere general creditor hoping to share some small portion of the money it earned with its capital and its labor. Rather, Union Pacific is entitled to be treated as a beneficiary with respect to these interline freight revenues which I hold are trust funds in the hands of IRRC.

Finally, the Trustee argues that Union Pacific has not sufficiently identified this money as interline trust funds, because Union Pacific has not traced the interline freight revenue into specific monies held by the Trustee. I find

this case is governed by the conclusive presumption that a trustee spends his own money first, before encroaching on a trust fund. Plaintiffs have therefore sufficiently identified this money as interline trust funds.

CONCLUSION

Union Pacific earned these interline freight revenues. The exigencies of the interline freight revenue collection process made it a trust beneficiary with respect to this money. This result is not affected by the Code or by the status of the parties' membership in the AAR. Further, Plaintiffs are not required to trace interline trust funds into specific monies held by the Trustee, since IRRC is conclusively presumed to have spent its own money before trust funds. Principles of common sense and elemental justice dictate that this money is held in trust by IRRC for the benefit of Union Pacific and the other interline railroads.

IT IS THEREFORE ADJUDGED, ORDERED AND DECREED that Union Pacific is entitled to $1,451,729.04 in interline freight revenues; that the Trustee holds certain funds, consisting of the Treasury Bills and Money Market account identified above, with interest earned thereon, in trust for the benefit of Union Pacific and the other interline railroads; that the Trustee shall pay said trust funds pro rata to Union Pacific and other similarly situated interline railroads that hold duly proved and allowed claims for interline freight revenues.

The parties are not precluded by this judgment from determining whether or not any other property now in possession of or hereafter acquired by the Trustee is impressed with a trust for the benefit of Union Pacific or other interline railroads. Actual distribution of funds to Union Pacific and other interline railroads shall be pursuant to further order of the Court.

Pursuant to F.R.C.P. 54(b), the Court further finds that there is no just reason for delay and expressly directs that final judgment be and hereby is entered in favor of Plaintiffs as aforesaid.

SO ORDERED.

ENTER: /s/ John F. Grady
JOHN F. GRADY
United States District Court

Dated: Oct. 15, 1986

APPENDIX G

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 84 B 13968

HON. JOHN F. GRADY

IN RE: IOWA RAILROAD COMPANY, AN IOWA CORPORATION,
Debtor,

Adversary No. 85 C 04463

UNION PACIFIC RAILROAD COMPANY, A UTAH CORPORATION, MISSOURI PACIFIC RAILROAD COMPANY, A DELAWARE CORPORATION, THE WESTERN PACIFIC RAILROAD COMPANY, A DELAWARE CORPORATION, and SPOKANE INTERNATIONAL RAILROAD COMPANY, A WASHINGTON CORPORATION,
Plaintiffs,

v.

IOWA RAILROAD COMPANY,
Debtor,

and

TERRY F. MORITZ, ITS TRUSTEE,
Defendants.

FINAL JUDGMENT ORDER

This matter came on for hearing on the Motion of Union Pacific, Missouri Pacific, The Western Pacific and Spokane International Railroad Companies (hereinafter

Union Pacific or Plaintiffs) for final summary judgment, that certain locomotives and potential causes of action claimed by the Trustee are impressed with a trust in favor of Union Pacific and other interline railroads. I find that there is no genuine issue as to any material fact respecting these assets and that Union Pacific is therefore entitled to judgment as a matter of law. The basis for my decision follows.

Introduction

In my earlier opinion in this adversary proceeding, I decided that interline freight revenue collected by Debtor or its Trustee is held in trust for the benefit of Union Pacific and other interline railroads. The issue now before the Court is whether a trust similarly extends to locomotives purchased by Debtor in April, 1984 and potential causes of action arising out of that purchase as "substituted trust assets" purchased with interline freight revenues.[1] The only reasonable conclusion is that those assets are impressed with a trust for the benefit of the interlines, for the reasons below.

Facts

The facts stated in my earlier opinion will not be repeated in total here. My judgment entered on October 15, 1986 held that certain cash assets identified in footnote 1

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[1] Union Pacific has withdrawn its claim to the GNMA certificate in the amount of $107,000 held by the Trustee, and the sum of $64,312.19 and accrued interest thereon segregated from the trust funds by my earlier opinion and Order. Further, with respect to Union Pacific's claim to the $197,382.17 in cash on hand as of December 31, 1984, the Trustee has represented to the Court that according to his information those funds have been spent subsequent to the Debtor's bankruptcy filing. While Union Pacific is not abandoning its claim to this latter amount, there is no property remaining in the Trustee's possession to which any interline trust respecting those amounts could attach. This Order, then, deals with all the property not addressed in my earlier opinion, claimed in Union Pacific's Motion for Final Summary Judgment in this adversary proceeding.

of that judgment are held in trust for the benefit of the interline freight carriers. Despite my earlier judgment, there is at least a $1,000,000 deficiency in interline trust funds. There is no dispute that the Debtor spent those trust funds. There is also no dispute that the total purchase price of the locomotives was at least $864,000 and that at least $738,000 of that purchase price was paid in cash by Debtor. There is no dispute that during the life of its operation, Debtor did not earn sufficient money to pay its operating expenses and also to purchase the locomotives. There is no evidence that the money used to purchase these locomotives derived from any source other than interline freight revenues. I therefore conclude that the money used to purchase the locomotives was in its entirety interline trust funds.

Discussion

The legal issue then becomes whether the locomotives, having been purchased with trust funds, become trust assets. I am persuaded by the fairness and reasonableness of those cases that hold that assets purchased with trust funds become trust assets, to the extent needed to make trust beneficiaries whole. *See* Bogert, *Trusts and Trustees*, § 928, Pgs. 424-25 (Rev.Ed.). Any other holding would result in a windfall to the estate's creditors, who contributed nothing to the purchase of these assets, and would also encourage a wrongdoing debtor as constructive trustee to convert trust assets to hard investments to defraud beneficiaries. I see no substantive difference between money investments (and interest earned thereon), and durable or capital goods investments in this regard. Likewise, any causes of action for conversion or related torts in connection with the purchase of these locomotives belong in equity to the interlines, which supplied the money for the purchase of the locomotives.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED:

That the locomotives purchased by Debtor in April, 1984 are impressed with a trust in favor of Union Pacific and the other interline railroads, just as the cash and cash equivalents, as previously decided; that any causes of action for conversion or related torts in connection with the purchase of the locomotives are also impressed with a trust in favor of Union Pacific and the other interline railroads; that the distribution of these assets to Union Pacific and the other interline railroads will be pursuant to further order of this Court; and, that there is no just cause for delay and judgment should be entered on the above forthwith, pursuant to Federal Rules of Civil Procedure Rule 54(b).

Date: Dec. 16, 1986

BY THE COURT:

/s/ John F. Grady
JUDGE JOHN F. GRADY